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03-9

December 31,2002

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DEC 3 1 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: National Exchange Carrier Association, Inc.
2003 Modification of Average Schedules

Dear Ms. Dortch:

Attached is an original and five (5) copies of the "2003 Modification of Average Schedules" submitted by the National Exchange Carrier Association, Inc. (NECA). This filing contains revised formulas for average schedule interstate settlement disbursements filed pursuant to section 69.606 of the Commission's rules, 47 C.F.R. § 69.606. Pursuant to this section, NECA is required to submit any proposed revisions to the formulas on or before December 31,2001. These modifications are proposed to become effective on July 1,2003.

Acknowledgement of receipt of this filing is requested. A duplicate letter is provided for this purpose.

Sincerely,

Attachments:
2003 Modification of Average Schedules
Service List

CERTIFICATE OF SERVICE

I hereby certify that a copy of the 2003 NECA Modification of Average Schedules was served on this 31st day of December 2002 by hand delivery or by first-class mail to the persons listed below.

By: [signature]
Shawn O'Brien

The following parties were served:

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

2003

NECA MODIFICATION OF AVERAGE SCHEDULES

December 31,2002

National Exchange Carrier Association, In

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SUMMARY

The National Exchange Carrier Association, Inc. (NECA) submits revised interstate average schedule formulas for Federal Communications Commission (FCC or Commission) approval, scheduled to be effective from July 1, 2003 through June 30, 2004. When approved, NECA will use these formulas to compute interstate access compensation (or settlements) for average schedule companies, that simulate the disbursements that would be received by representative cost companies.

NECA estimates carriers can expect, on average, an overall settlement increase of 3.97% as a result of the new formulas.

Impacts of these formula changes on individual average schedule companies will vary, depending on each company's size and demand characteristics. Of the 506 average schedule study areas, NECA projects that 495 will experience settlement increases. **A** small group of study areas will experience overall settlement increases greater than 10%. These study areas derive a large percentage of their settlements from the Common Line Access Line and Central Office formulas, which are increasing for most study areas. Another small group of companies will experience overall settlement decreases. These decreases are primarily due to two factors: (1) a decrease in the Common Line formula for study areas in the 500 to 1,000 lines per exchange band; and (2) a decrease in the Line Haul Distance Sensitive Formula.

Notwithstanding proposed overall increases in settlement rates, many companies may yet experience overall settlement decreases in the coming year, as market conditions cause continued declines in subscribership and calling volumes in many areas. In this average schedule study, for the first time, NECA projects overall decreases in interstate access minutes. Such demand decreases contribute to higher ratios of embedded cost to demand, causing proposed increases in settlement rates.

Shortly after this filing is made, **NECA** will send to all average schedule companies a letter previewing the proposed average schedule formulas. This notification presents preliminary formula impacts and offers reasons for the proposed changes. This notification will also provide information that will allow each average schedule company to calculate its new settlement amounts on its own or with the assistance of **NECA** regional staff.

I. INTRODUCTION

The National Exchange Carrier Association, Inc. (NECA)[1] herein proposes modifications to current interstate average schedule formulas, for Federal Communications Commission (FCC or Commission) approval. These modifications are scheduled to be effective from July 1,2003 to June 30,2004.

A. Background

Exchange Carriers (ECs) that participate in NECA's access charge pools receive compensation for providing interstate access services either on the basis of their individual costs or a set of interstate average schedule formulas. Cost separation studies, performed in accordance with Parts 32, 36, 64, 65 and 69 of the Commission's rules, involve extensive data collection, analysis and reporting. The Commission has recognized that it is inefficient to require cost separation studies for all companies. Not all ECs have the resources available to perform these studies. Commission rules accordingly permit certain ECs to receive interstate access compensation (or "settlements") based upon a set of "average schedule" formulas developed by NECA.[2] The average schedule formulas are designed to "simulate the disbursements that would be received . . . by a [cost study] company that is representative of average schedule companies."[3]

Settlements made on the basis of average schedule formulas benefit both ECs and interstate ratepayers. The average schedule method substantially reduces administrative costs for these smaller

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1 NECA administers interstate access charge tariffs and revenue pools on behalf of member Exchange Carrier (ECs), and the preparation and filing of average schedule formulas, in accordance with the Commission's Part 69 rules (47 C.F.R. Part 69).

2 Compensation to ECs using these average schedule formulas is based on an EC's number of access lines, access minutes and other demand variables.

3 47 C.F.R. § 69.606(a).

ECs by eliminating the need to conduct detailed accounting and engineering cost studies required of cost companies. This cost savings, in turn, benefits ratepayers![4]

Section 69.606 (b) of the Commission's rules requires NECA either to file revised formulas on or before December 31st of each annual period, or to certify that no such revisions are necessary.[5] Accordingly, each year, NECA conducts an extensive study of cost and demand data to determine if revisions to the average schedule formulas are warranted. NECA's annual study involves selecting a statistical sample of both cost and average schedule companies and collecting accounting and demand data from the selected companies![6] NECA then develops mathematical models ("allocation factor models") that describe how representative cost companies allocate their total costs to the interstate jurisdiction and to individual access charge categories.

The study also projects cost and demand data, obtained from sample average schedule companies, to account for growth. NECA then applies the allocation factor models derived from representative cost companies to sample average schedule company total company account data. This enables NECA to determine the interstate access portion of average schedule company total costs, thereby simulating the effects of performing interstate cost studies for these companies. Finally, NECA develops formulas that relate sample average schedule company interstate access costs to various commonly-used demand units (such as access lines or access minutes) or combinations of demand units and other factors (such as lines per exchange). In developing these average schedule formulas,

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4 *See* Revisions to the Average Schedules Proposed by NECA on October 3, 1988, *Memorandum Opinion and Order*, 4 FCC Rcd 2804 (1989) (1989 *Order)*.

5 47 C.F.R. § 69.606(b). The current formulas have been in effect since July 1, 2002.

6 Statistical sampling is commonly used as a cost-effective method of deriving estimates for a population. A properly designed sample will provide an accurate representation of the entire population, but at a fraction of the cost of examining the entire population.

NECA carefully analyzes different statistical models and selects the model that has the best fit to actual data. Upon Commission approval, these formulas are used by NECA to compute interstate settlements for average schedule companies that simulate cost study results.

In preparing proposed formula revisions, NECA receives valuable assistance from an Industry Average Schedule Task Group. This group consists of EC representatives sponsored by industry associations (*i.e.* the National Telephone Cooperative Association, the Organization for the Promotion and Advancement of Small Telecommunications Companies and the United States Telecom Association). The Task Group meets several times each year during the course of NECA's study, reviews the steps taken in developing the proposed formulas, advises NECA regarding the development of procedures for administration of the formulas, and assists the NECA Board of Directors in evaluating final proposed formulas.

Task Group participation **assures** that average schedule companies are able to participate fully in the development of **the** average schedules, and also have an opportunity to provide input to NECA regarding the ways in which changes in the settlement formulas can affect their networks.

B. Overview of This Filing

Each of the steps followed in NECA's study ***are*** explained in detail in this Filing? Section II describes the statistical sampling methods that NECA used in its data collection for settlement

7 The instant filing is referred to herein as the "2003 Filing" and the data collection and analyses upon which this filing is based are referred to as the "2002 Study." The proposed settlement formulas proposed herein ***are*** referred to as **the** "2003 Schedules." References made herein with respect to previous years' filings, studies and settlement formulas use similar nomenclature.

formula development. Section III contains a description of the sources and types of data NECA collected from cost and average schedule companies. Section IV explains the methods NECA used to develop cost allocation factor models from sample cost company data. Section V describes how NECA projected growth in historical cost and demand data, to develop cost and demand data applicable to the period the proposed formulas will be in effect. Section VI explains how NECA calculated Interstate and Access Category costs by account for each sample average schedule study area. Section VII explains how NECA develops the "best fitting" mathematical formulas for use in determining settlements and explains adjustments made to the formulas to reflect the allocation rules mandated by the MAG Order.[8] NECA also explains in Section VII how the proposed formulas will affect average schedule companies. Section VIII lists the current and proposed average schedule formulas. Finally, the attached appendices contain all of the data used in NECA's study. These data enable the Commission and interested parties to verify NECA's Study results.

The *2003* Filing utilizes the five-year sampling design developed in ***1998 (1998*** Design). **This** Design selects a five-year sample, and then assigns members of the sample to data collection years. The ***1998*** Design takes extra precautions to ensure that additional "small" average schedule study

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8 Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Service for Local Exchange Carriers, ***Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket*** *No.* ***00-256, Fifteenth Report and Order in*** *CC Docket* ***No. 96-45, and Report and Order*** *in CC Docket* ***Nos.*** *98-77 and 98-166 ,16* FCC Rcd ***19613 (2001)*** (MAG Order).

areas are included![9] The design entailed defining stratification attributes, determination of sample size, and allocation of the sample to strata, sample selection and assignment of study areas to specific data collection years. The 1998 Design utilizes a number of study area attributes, including: size grouping (based on number of access lines per exchange); traffic volume *(high* or normal based on switched access minutes per access line); and circuit density (high or low based on switched terminations per exchange). Section II of this filing explains the 1998 Design in detail.

Additionally, in the 2003 Filing, NECA continued to adjust formulas to reflect the allocation rules mandated by the MAG Order. As in the 2002 Filing, NECA made the following adjustments: (1) reallocation of a portion of General Purpose Computer costs from access categories to the Billing and Collection category; (2) reallocation of Switch Line Port costs from the Central Office to the Common Line access category; and (3) reallocation of Transport Interconnection Charge costs for Transport to Common Line.

C. Effects of Prouosed Modifications on Average Schedule Comuanies

1. Formula Changes

NECA develops average schedule formulas in the common line and traffic sensitive access tariff categories. Common line formulas include a Common Line Access Line formula, a Universal Service Contribution Formula, a Common Line Line Port formula, a Common

9 "Small" study areas are defined as those with fewer than 200 access lines per exchange. This is in response to a Commission concern first brought to NECA's attention in December 1997. *See* National Exchange Carrier Association, Inc. (NECA), Proposed Modifications to the 1997 Interstate Average Schedule Formulas and Proposed Further Modifications to the 1997-98 Interstate Average Schedule Formulas, AAD 97-2, AAD 97-109, *Order on Reconsideration and Order,* 13 FCC Rcd 10116 (1997).

Line Transport formula and a Rate of Return Factor formula. Traffic Sensitive formulas include: the Traffic Sensitive components of a Central Office formula, Line Haul Transport formulas, and an Intertoll Switching formula; a Special Access formula, Signaling System 7 formulas, an **Equal** Access formula, and a Network Administration formula.

Beginning July 2003, carriers can expect, on average, an overall settlement increase of 3.97% as a result of the new formulas. **This** increase reflects a 4.44% increase in Common Line (CL) settlement rates and a 3.38% increase in overall Traffic Sensitive (TS) settlement rates.

NECA proposes a 3.03% increase in the Common Line Access Line formula, primarily because of demand reduction and cost growth.

The Central Office (CO) formula is proposed to increase 10.15% on average, primarily due to increased cost allocations, and decreased switched access minutes.

The Distance Sensitive Line Haul formula will decrease by 4.79% on average, primarily due to the continued **shift** from copper cable facilities to lower cost fiber networks.

The Non-Distance Sensitive Line Haul formula is proposed to increase 13.98% on average, reflecting the lower growth of circuit terminations.

NECA proposes to keep the Intertoll Dial settlements formula essentially unchanged (an increase of 0.05%).

NECA is proposing a 5.94% decrease on average in Special Access formula, reflecting continued significant growth in services outpacing cost additions.

NECA proposes a 1.03% increase on average in the Signaling System (SS7) formula, reflecting replacement costs of older equipment.

2. <u>Effects on Individual Average Schedule Companies</u>

Effects of these formula changes on individual average schedule companies will vary depending on each company's size and demand characteristics. A ***summary*** of company changes by access line size is included in Section VII.

Of the 506 average schedule study areas, NECA calculates that 495 will experience formula increases. **A** small group of study **areas** will experience overall formula increases greater than 10%. These study areas derive a large percentage of their settlements from the Common Line Access Line and Central Office formulas, which are increasing. Another small group of companies will experience overall formula decreases. These decreases appear to be primarily due to two factors: (1) a decrease in the Common Line formula for study areas in the 500 to 1,000 lines per exchange band; and (2) decrease in the Line Haul Distance Sensitive Formula.

Small rural exchange carriers are experiencing a period of unprecedented falloff in subscriber demand. As a result, even with formula increases proposed by NECA, many companies will experience overall settlement decreases. These decreases could hamper the ability of these carriers to continue to provide quality service. For this reason, it is especially important to assure that the formulas are adjusted to reflect expected cost and demand levels for the 2003 - 2004 test period.

Some companies may be affected more significantly than others. In the event that any average schedule company files a petition demonstrating hardship, NECA requests that the Commission consider carefully the extent of individual company impacts associated with total settlement changes from all formulas and the potential need for transitional assistance in adjusting to new formula levels.

D. Communications with Average Schedule Companies

NECA will send to all average schedule companies a letter previewing the proposed average schedule formulas. This notification will present preliminary formula impacts and offer reasons for the proposed changes. This notification will also provide information that will allow each average schedule company to calculate its new settlement amounts on its own or with the assistance of NECA regional staff. In addition, NECA will update average schedule training and other materials routinely supplied to average schedule companies to reflect the new settlement formulas.